

**A STUDY ON SMEs FINANCING ISSUES IN COSTA RICA: BUSINESS
SUCCESS OR FAILURE**

By

Harold Villalobos Monge

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

MASTER OF BUSINESS ADMINISTRATION

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ABSTRACT

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Costa Rica's Government and its banking system play the most important role in supporting and developing small and medium enterprises (SMEs). The plans and programs to assist and finance these companies have to be tremendously strong with the purpose of making them outstand in the market. If SMEs improve their situation, they would attract more local and international investors, which are crucial to boost the economy. However, the plans and programs done by the government have not been successful. They are not known by most of the SMEs executives, and those who know the programs say that they do not fulfill their businesses' needs at all. In addition to the above crisis, the government is dealing with the Central America Free Trade Agreement (CAFTA) between Central America countries and United States of America. Citizens are concerned with the possible increase in the unemployment rate, particularly on SMEs, and for this reason people are not supporting the agreement. Despite all these pitfalls, SMEs play a vital role in the economy of Costa Rica, and the government must fully understand their role. The government must offer special treatment to SMEs by including policies that promote a positive business environment for these entrepreneurs. To be more successful, this business environment must include a better access to credit, easier lending requirements, more funding to private institutions, and newer tools (i.e. clustering).

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To Cecy, my wife and best friend

To my parents for their never-ending support

With a special dedication to God and Juan Pablo II

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I. INTRODUCTION

SMEs play a critical role in the economy by providing job opportunities, enhancing the quality of human resources, nurturing a culture of entrepreneurship, fostering creativity and opening up new business opportunities. However, SMEs are in need of improving technology to remain competitive in an ever-changing global market, but lack the access to financing the implementation of these changes. This paper studies government and commercial banks' policies towards assisting and financing SMEs in Costa Rica, and the enormous impact SMEs will receive from the Central America Free Trade Agreement (CAFTA) between Central America countries and United States of America.

The largest source of capital for SMEs in Costa Rica is commercial banks. Since they are key suppliers of credit to small firms, a point to analyze is how these organisms support the creation of new enterprises, plus the role of Costa Rica's Government on the supply of funding for SMEs by introducing rules and regulations to encourage banks and state-owned institutions to create uniquely tailored programs to the need of small firms. Similarly, a point to analyze is SMEs' borrowing requirements, which most of the time are small and frequently do not appeal to these financial institutions. Certainly, more collateral is required than SMEs can pledge. Banks face lending difficulties due to lack of accurate reliable information on the SMEs financial condition and performance; unconvincing and weak business plans, weak management, and weak information technology.

In addition, the most common problems for SMEs will be analyzed. They are the lack of access to market information and technology, the low quality of human resources, and the lack of access to capital. The study will identify if these problems

are reflected by SMEs optimism, sometimes in the face of facts, about how quickly they can grow the business and about the amount of market they can grab from competitors. Another symptom of poor understanding might come from the discrepancies between their plans and what the market requires. Thus the danger is that the plans they do make may be unrealistic. Another problem SMEs encounter is procurement. The study will detect if the Costa Rica's Government gives them any type of business opportunity or only big corporations always have the advantage. In reality authorities invite only the top companies to the bidding process in the mistaken belief that they have a duty to determine which of the applicants have submitted the most economically advantageous application, and these will undoubtedly be those with the best track record, largest number of staff, highest turnover etc, i.e. the largest companies.

Finally, the study will evaluate current issues that affect SMEs in Costa Rica, particularly the Central America Free Trade Agreement (CAFTA) between Central America countries and United States of America, which is the key export market for United States' important manufacturing sectors such as information technology products, agricultural and construction equipment, paper products, chemicals and medical and scientific equipment. This agreement should affect significantly SMEs businesses in Costa Rica. More than half of current U.S. farm exports to Central America became duty-free, including high quality cuts of beef, cotton, wheat, soybeans, key fruits and vegetables, processed food products, and wine, among others. To note the United States and Central America enjoy a strong and growing trade partnership. U.S. exports to the CAFTA countries have grown over seventy percent since 1996, totaling \$10.9 billion in 2003.

The SMEs' behavior has been conditioned by a dynamic economy and specific

politics in their development, which cover several areas, but for the purpose of this study the analysis will focus in financial aspects only. In addition, since the data available to write this thesis does not provide all the financial facts needed, it will classify Costa Rica's companies based on number of employees only. To note, the available statistics do not cover all the industry sectors of Costa Rica. Most of the studies give emphasis to the manufacturer industry. For this reason, this thesis will also pay attention to this industry mostly.

This thesis is a proposal to fortify the financial system the government is applying to SMEs in Costa Rica currently. The main five ingredients enclosed in this document are: description of how important SMEs are for the economy, how government, its banking system and private institutions are helping SMEs at present, problems that SMEs face, CAFTA impact on SMEs, and analysis of some strategic alternatives to aid and support SMEs. This work concludes with one recommendation on how the government can do a better job to achieve a superior financial system to allow SMEs develop the Costa Rica's economy.

II. SMALL AND MEDIUM ENTERPRISES DEFINITION

The definition of SMEs varies around the world, and each country government classifies them based on the number of employees and/or annual sales firm's assets. The International Finance Corporation¹ defines SMEs as firms with less than 300 employees and total assets less than US\$15 million. In smaller economies, such as Costa Rica, SMEs are defined as less than 100 employees. Whatever the definition, and regardless of the size of the economy, the growth of SMEs is crucial to Costa Rica. Thus, SME's are extremely important contributors of Costa Rica's economy. According to the Economic Commission for Latin America (ECLA)² -the Spanish acronym is CEPAL - the industrial sector has approximately 4.842 companies, and ninety-five percent are considered SMEs. They also represent twenty-eight percent of Costa Rica GNP and ninety percent of the total manufacturing companies. SMEs hold twenty-six percent of the total workforce in the country and represent fifty-one percent in the private sector (IADB, 20).

The Ministry of Economy, Industry and Commerce of Costa Rica divides the enterprises into four categories based on number of employees, annual sales, and capital expenditure. The micro-enterprises have less than ten employees and US\$150,000 in annual sales. Small companies have between five and thirty employees and annual sales of US\$500,000. Medium companies have between thirty-one and one hundred employees and annual sales do not exceed a million dollars. Corporations employ over a one hundred workers and annual sales exceed a million dollars.

¹ The International Finance Corporation (IFC) is the largest multilateral source of loan and equity financing for private sector projects in the developing world. It promotes sustainable private sector investment as a way to reduce poverty and improve people's lives.

² ECLA, which is headquartered in Santiago, Chile, is one of the five regional commissions of the United Nations. It was founded for the purposes of contributing to the economic development of Latin America, coordinating actions directed towards this end, and reinforcing economic relationships among the countries and with the other nations of the world.

Table A

**Enterprises classification based only
on number of employees**

Employees	
Micro-enterprises	Less than 10
Small	Less than 30
Medium	Less than 100
Corporations	More than 100

Source: SME's indicators in FUNDES countries. 2002

Table A shows the SME classification prepared by FUNDES³, which is quite the same as the one mentioned above by the Ministry of Economy, Industry and Commerce. As it was mentioned in the introduction, the classification for this study will be only based on number of employees in the manufacturing industry.

³ FUNDES is a network of private institutions and entrepreneurs created in 1984 as an association between FUNDES Switzerland and leading entrepreneurs in various Latin American states. Since 1996 it focuses on know how distribution for SME offering training, consultancy and facilitates access to financing.

III. THE DEVELOPMENT OF SMALL AND MEDIUM ENTERPRISES

According to ECLA, in the last years, SMEs have been influenced by three different aspects. First, during the 80's and 90's Costa Rica reduced some import and export tariffs in order to open its economy and increase the FDI in the country. Second, in the 90's the economy experienced dramatic ups and downs, which affected the domestic demand. This point is important to mention since most of the SME's businesses are oriented to the domestic market. Third, Costa Rica started to put more attention to the process of globalization. This policy affected in some part the positive development of the SME's, specially the medium ones. More of the actions taken by the government did not define the business categories and made its vision to favor more the big corporations. These three elements had an effect on the SME's category, for instance between the years of 1994 and 1997 the expansions of SME's and the employment level decreased compared to previous years (De Paula and Bolaños 10). Figure B shows how the number of employees in the medium manufacturing enterprises decreased in 1997; due to the recession period the country suffered during the period 1995-1997. Also, it illustrates the importance of SME's in the Costa Rican economy. Basically, ninety-four percent of the employees in this industry work in micro, small, and medium enterprises.

Table B
Number of employees in the manufacturing industry

	1990		1994		1997	
Less than 31 employees	3823	85.7%	3938	85.1%	4416	87.1%
31-100 employees	400	9.0%	402	8.7%	369	7.3%
More than 100 employees	240	5.4%	289	6.2%	284	5.6%

Source: De Paula and Bolaños. Page 12. 1999

A. THE VITAL ROLE OF SMEs INTO SOCIETY AT PRESENT

SMEs are not important only to create jobs in Costa Rica. They play important roles in the economy, such as innovation and economy's stimulation. Entrepreneur executives who create new businesses are making the economy stronger and more competitive in the local and global environment, for they bring innovation into the market, which stimulates the economy. SMEs also serve some local and niche markets with products and services not provided by large companies or corporations. If SMEs do well they could become large businesses. In this circumstance, they can be considered "both the beginning of the economy and the rest of the economy" ("The Small" 5).

Another role SMEs play is creators of business talent and entrepreneurship spirit. Both aspects are fundamental to enhance the economy of the country. In the political area, the government must generate a positive scenario that allows individuals, who are capable to boost the market up with innovative and fresh ideas, to start new businesses. The first step to generate this scenario is by allowing entrepreneurs to have credit access in the banking system. In the social area, the government must foster education and family values, which are extremely important to generate motivation and abilities in individuals to become the next leaders and founders of SMEs in Costa Rica. These actions, political and social, would be amazing tools to fight against the unemployment rate, and also they would enhance the quality of living by creating wealth and increasing productivity levels (Perez 27).

In conclusion, since SMEs play a vital role to the Costa Rica's economy, they deserve special treatment from the government. The authorities must understand that without their help, SMEs would not do well; they would not become successful companies and help the country.

B. OTHER OPPORTUNITIES FOR THE GOVERNMENT TO DEVELOP SMEs.

In the past, the main problem SMEs had was mostly financial resources, but nowadays these companies need help in business development, technical assistance, training, fiscal and labor assistance among others (Bonilla 28). In the international market, SMEs' capacity to grow has been affected due to the high entry costs in market research and product development. SMEs' needs have been government support in export and import matters and better information technology and business training to be competitive in the international market. Another aspect is the plant capacity of the SMEs. The size production of these companies is too small to match the total demand in other markets. However, many SMEs participate in the international business in an indirect way, since they supply importing corporations with their products (De Paula and Bolaños 10).

Another aspect government must analyze and help SMEs is procurement. The government must award SMEs with direct prime contracts and subcontracts for the purchase of goods or services. These contracts must go to those industries that receive less financial support by the government, such as agriculture, stockbreeding, and fishing. Industry support analysis will be studied in the section "Role of the government and its financing system to support SMEs."

During the last two decades, the right way to support SMEs has not been clear, but several entities, such as SICE⁴ and FUNDES, have developed new projects to help these businesses. For instance, in 2001 FUNDES launched MiPyme.com, which is a portal for small and medium enterprises in Latin America that contains a large

⁴ The Foreign Trade Information System -the Spanish acronym is SICE-, is the information technology arm of the Trade Unit of the Organization of American States (OAS). Its goal is to provide the most complete information and documents on trade in the Western Hemisphere as possible.

information section and an online catalogue functionality that is provided for free, together with other online tools. The objective of this web is to be the most important solution provider for SMEs in the region.

Taking SICE and FUNDES programs as example, the Costa Rica's Government, with the purpose of increasing the impact of SMEs plans, must facilitate access to market information, technology, training, and capital. Currently, the fastest way to achieve this purpose, locally and internationally, is by encouraging the local banking system to create tailored credit programs for each industry sector.

IV. COSTA RICA'S BANKING SYSTEM

The Central Bank is the entity in charge to make the banking policy for the financial sector in Costa Rica, which consists in the following body:

- 3 State-owned commercial banks
- 19 Private commercial banks
- 1 Workers' bank
- 1 State-owned mortgage bank
- 4 Mutual house-building companies
- 15 Private finance companies
- 27 Savings and loans cooperatives
- 30 Investment and retirement funds
- 1 State insurance company

The three state owned banks are National Bank of Costa Rica (BNCR), Costa Rica Bank (BCR), *Banco Crédito Agrícola de Cartago* (BanCredito). BCR is the most profitable and possibly best-run state commercial bank. BNCR is the largest state commercial bank in both assets and number of locations, although BCR has nationwide coverage also. BanCredito is the smallest state bank. These banks are backed by the Costa Rica's Government. They also have better coverage; practically any town in Costa Rica has a BNCR and/or a BCR too. As most of any Central America bank, the disadvantages are the long lines that occur in busy locations and on peak days. Also, these banks may have an English speaker on the staff in the larger branches, but smaller branches are not as likely to. An important fact to mention is that these three state-owned banks jointly founded the International Bank of Costa Rica - the Spanish acronym is BICSA. This private commercial bank is chartered in the Bahamas and it has branches in Panama and Miami with a representative office in Costa Rica ("Banking").

The private commercial banks are relatively small. In 1995 private commercial banks started to offer checking and passbook savings accounts to the public. Before this year the banking law only allowed state-owned banks to offer these services.

This law also granted private banks access to the Central Bank discount window and emergency loan facilities. It also requires private banks to fulfill one of two requirements: (1) opening four branches in rural areas and depositing the equivalent of ten percent of demand and short-term time deposits (thirty days or less) in a state-owned bank; or (2) depositing the equivalent of seventeen percent of demand and short-term time deposits (thirty days or less) in a state-owned bank. The largest private banks in assets are Interfin Bank, San Jose Bank, Banex Bank and BanCrecen. San Jose Bank offers a good mix of fast service, numerous locations (including several mini-branches in supermarkets) and big variety of services. They are a part of San Jose Group, which owns Credomatic, one of the largest issuers of credit cards in Costa Rica. BanCrecen offers even more locations, but it is not a full service bank, although it offers most of the important services in its branches. Another private bank that many foreigners use is Scotiabank. This is a Canadian bank, so most of the staff speaks excellent English. The private banks have several advantages over the state banks, shorter lines, faster service, more English speaking staff and more agility in bringing new products and services into the market. Today, many Costa Rican banks have subsidiary or affiliated banks registered offshore. Regulated by the General Supervisory Agency of Finance⁵ -the Spanish acronym is SUGEF-, these offshore entities are not permitted to capture deposits or lend money within Costa Rica. Other reforms stipulate that any SUGEF-regulated holding company or financial group owning twenty-five percent or more of the equity of an offshore entity must include the offshore assets on its balance sheet. However, SUGEF does not have regulatory authority over the operations or individual accounts of the offshore entities (“General”).

⁵ The General Supervisory Agency of Finance enforces compliance with Costa Rica Central Bank policies.

Banks in Costa Rica have started offering Internet banking over the last years, now it is widely available. Most of the state banks offer services online and many private banks do as well. The common services are: account balances, up-to-the-minute account statements, transfers between accounts in the same bank, transfers to other people's accounts within the same bank, requests for new checks and savings passbooks, payment of utilities and other services ("Banking").

Even though, the Costa Rica's banking system is well-built and has helped the country economy to grow, there is still not fulfilling all the SMEs' needs. These needs are not just Internet banking service or English speaking staff, but most importantly with reachable collateral and lower interest rates. By providing SMEs with more desirable working conditions, Costa Rican SMEs would also help the economy to grow.

V. THE SMALL BUSINESS ECONOMY

According to FUNDES, in the year 2000 there were 74,866 companies in Costa Rica: seventy-eight percent were micro-enterprises, twenty percent were SME's, and two percent were big companies ("Indicators"). Table C shows the number of companies in each sector.

Table C
Number of companies in Costa Rica
2000

Companies	
Micro-enterprises	58,620
Small & Medium	14,898
Big	1,348

Source: SME's indicators in FUNDES countries. 2002

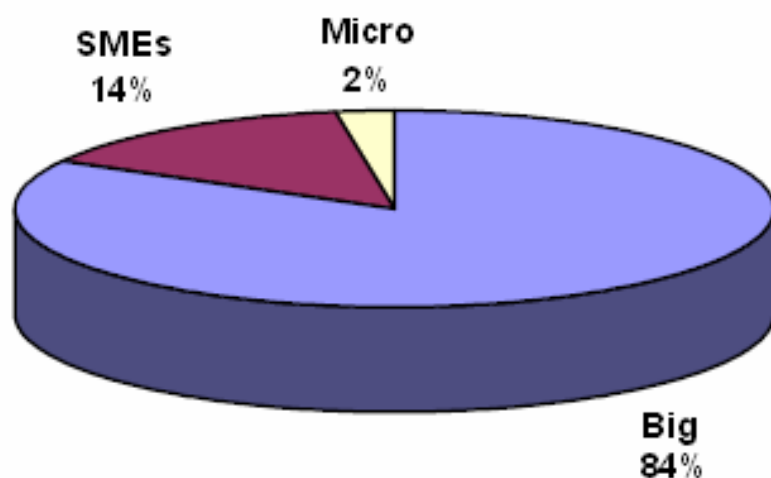
SMEs activities are particularly essential in the economy. For instance, based on the information provided by PROCOMER⁶, SMEs represent approximately twenty-eight percent of Costa Rica GNP and hold twenty-six percent of the total workforce in the country ("SMEs"). Despite their importance in the economy, they have little participation in the exporting industry. For instance, in the exporting industry SMEs represent sixty-two percent of the total amount of companies; however, they only participate in fourteen percent of the total exporting businesses. The scenario is even worse for micro-enterprises as they stand for seventy-eight percent of the total amount of companies, but they only represent two percent of the total exports.

Figure A shows the small participation SMEs have in the total amount of exports. This percentage states once again the biggest political problem SMEs are facing: unfair participation in the market⁷.

⁶ PROCOMER (Costa Rica Foreign Commerce Promoter) is a public service institution that operates as a private company. Its mission is to promote the successful entry of export companies in international markets. PROCOMER is a center for technical and strategic information on foreign trade. It is the official contact point in consolidating the relationship between exporters and importers.

⁷ This unfair participation was discussed in a more detailed manner in the section "The Development of Small and Medium Enterprises."

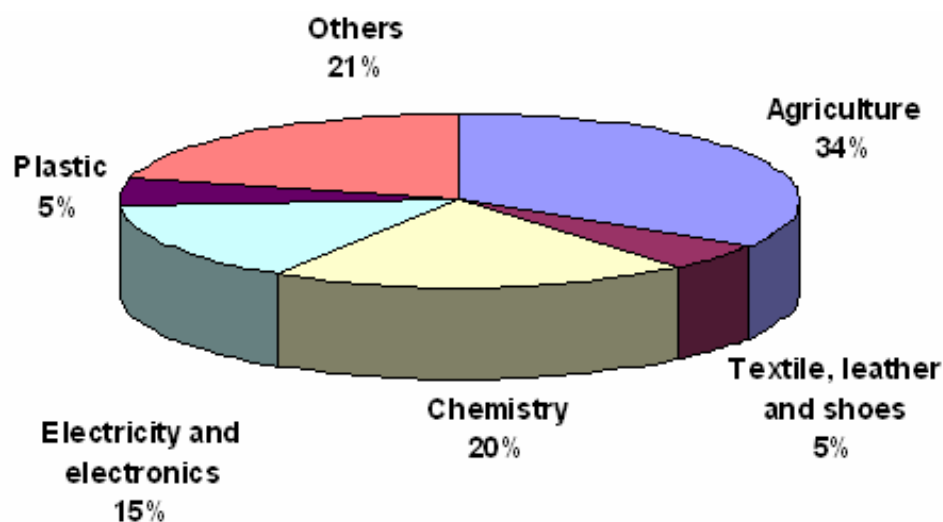
Figure A
Exports by company size



Source: Procomer. 2004

Within the 14% of participation by SMEs in the total amount of exports the most important industry is the agriculture (34%) followed by chemistry (20%) and electricity and electronics (15%). Figure B shows other industries' figures.

Figure B
SMEs exports by industry

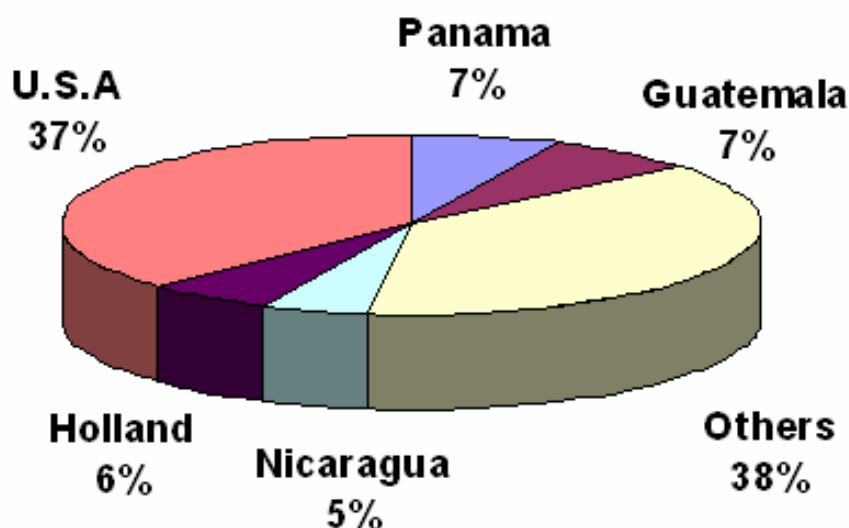


Source: Procomer. 2004

Figure C illustrates that United States is the most important country for Costa Rica in the exporting businesses. This country receives the majority of Costa Rica's exporting goods (37%). The second most important region for Costa Rica is Central America itself, where Panama represents seven percent, Guatemala seven percent, and

Nicaragua five percent. There is also an important European country for Costa Rica, Holland (5%). The main business between these two nations is the flower industry, where Costa Rica has distinguished itself around the world.

Figure C
SMEs exports by country



Source: Procomer. 2004

There is a need to execute effective mechanisms to help SMEs to go international, so they can compete for this market and take part of the free enterprise benefits. The section “Role of the government and its financing system to support SMEs” will examine if Costa Rica’s Government and its banking system are implementing the appropriate programs in order to achieve this internationalization.

A. FOREIGN DIRECT INVESTMENT IN CENTRAL AMERICA

An important piece in the SMEs’ economy is the Foreign Direct Investment. Even though Costa Rica reduced some tariffs in order to open its economy and increase the FDI in the country, Central America is still not that attractive for foreign investors. Two basic reasons explain why: all the economies have not integrate themselves into one and the insecurity issues: personal, juridical, and regulatory (Velasquez et al. 22).

According to Manuel Agosin, Counselor of the IDB⁸ -the Spanish acronym is BID- for Central America, these small countries are still fragmented, which is negative for FDI. He also argues that foreign investors must feel that the investment transactions are fair and equal for every party involved in the deal (Velasquez et al. 23).

As a result, the FDI inflows for Central America are relatively small with only US\$18,718 millions from 1997 to 2004 (refer to table D). These investments come from United States, Central America itself, Mexico, Europe and Canada.

Table D
FDI in Central America in US\$ millions

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Belize	17	12	18	47	18	17	-	-	-
Costa Rica	427	408	613	669	400	454	662	577	585
El Salvador	(5)	59	1,104	237	185	279	470	104	389
Guatemala	77	84	673	155	228	455	111	116	125
Honduras	91	122	99	237	282	189	175	198	195
Nicaragua	97	173	184	300	254	150	204	201	261
Panama	410	1,256	1,219	517	393	405	78	791	467
Total	1,114	2,114	3,910	2,162	1,760	1,949	1,700	1,987	2,022

Source: Velasquez et al. *América Económica*. 2005

As it was mentioned above, SMEs obtained benefits during the 90s from the FDI inflows. In fact, Central America economy grew more than the other regions, such as Asia, Africa and Central Europe (Velasquez et al. 25). However, since the year 2000, the FDI started to decrease and become volatile due to two reasons: stopping privatization in the region and China and India becoming more attractive markets.

According to Alvaro Calderon, ECLA Economy Officer, the amount of FDI received before year 2000 was not fully utilized to enhance and increase the number of new businesses, especially SMEs. However, Costa Rica was the most successful country in Central America in bringing new investments after the year 2000 (refer to Table D). In twenty years, Costa Ricans went from selling bananas and coffee to export high

⁸ The Inter-American Development Bank (IDB) is the oldest and largest regional development bank. It is the main source of multilateral financing for economic, social and institutional development projects as well as trade and regional integration programs in Latin America and the Caribbean.

technology. This advancement is the bait to bring more foreign investments to the country. According to ECLA, “[Costa Rica] has a more clear understanding of its strategic objectives; it applies the adequate instruments of national policy and has solid national institutions” (Velasquez et al. 27). In conclusion, when planning is sustainable in the short and long run, more financing resources arrive to help develop businesses locally and internationally.

VI. SMALL BUSINESS FINANCING RESOURCES

The accessibility of financing resources is not the only obstacle SME's are facing for their development. Other aspects that affect SME's to make a profit are managerial training, technology availability, appropriate quality control standards, and market research. To achieve all these goals, SMEs must have access to an adequate financing program supported by the government and its commercial banking system. Obviously these programs inquire solid and secure businesses from the SMEs. However, SMEs show deficiency in strong financial condition and performance, extremely weak future plans to reimburse the bank loans, and lack of technology and management to compete in the local or international market. Most of the time, the required collateral and the high interest rate cannot be matched by the SMEs. Since it is really difficult for them to borrow money from the banks, SMEs founders use their own personal savings or loans to open their businesses (De Paula and Bolaños 16).

A. ACCESS TO CREDIT

FUNDES of Costa Rica conducted a study to valid the development problems SMEs are facing. One of the most important problems is obviously access to credit. The research carried out 553 interviews to executives from four different sectors: agriculture, manufacturing, commerce, and services (Refer to Appendix A).

The study uncovers points that explain the accessibility problems SMEs find to obtain loans. The most important barrier SMEs encounter is interest rate. The second most important barriers are legal and bank fees, collateral, general requirements to be a creditor prospect, paperwork, and approval period. Other significant points in the study were loan terms, loan information, and commercial banks information.

According to the interviews, seventy-nine percent of the executives considered that

the interest rate condition is the same compared to five years ago or worsening, while only nineteen percent think that the interest rate is getting better. This point refers to the high percentage financing system collects from its creditors, and how it stops executives to even start the paperwork to obtain a loan. However, the rest of the points legal and bank fees, collateral, general requirements to be a creditor prospect, paperwork, and approval period, loan terms, loan information, and commercial banks information have slightly improved compared to these same points five years ago.

However, overall results said that the total conditions to obtain a loan still the same compared to five years age. According to the interviewees, commercial banks have not completely enhanced their systems and requirements to facilitate loans. Some executives said that the conditions are even worse than five years ago.

The main problem banks face when they want to grant a loan is collateral. Banks want to study SMEs' current financial standing and future business prospects, which indicates if SMEs possess adequate capacity to repay the entire loan amount. If banks obtain and approve this information maybe the collateral would be cut, and SMEs would be able to match it.

B. LACK OF PUBLIC POLICIES IN SUPPORT AND ENCOURAGEMENT

According to the FUNDES' study, the absence of government policies, which promote and encourage SMEs, is a high priority solution to seek. There are also two points that boost this problem up. The first one is the homogeneous legal treatment government gives to all SMEs sectors. The second one is the lack of communication and coordination among public and private institutions, which minimize the impact of any taken action.

Due to these issues, it is necessary to adopt a special approach concerning the SMEs. If different support and encouragement policies are applied to different types of SMEs,

the needs and demands of these enterprises will be satisfied. Also, special research must be conducted to understand the real needs and demands of the SMEs and the cooperation between the public and private sectors.

Although Costa Rica has done great efforts to support SMEs, the research points out that only thirty-seven percent of the interviewed executives know about these programs. This figure is evidence that there is not a significant knowledge about the politics and programs that the government and public institutions implement to develop, support, and promote SMEs. Even more alarming are the figures about the quality of politics and programs as found by the research. Fifty percent of the interviewees state that the government programs and politics do not fulfill their businesses' needs at all, even though seventy percent of them said that they really need these plans.

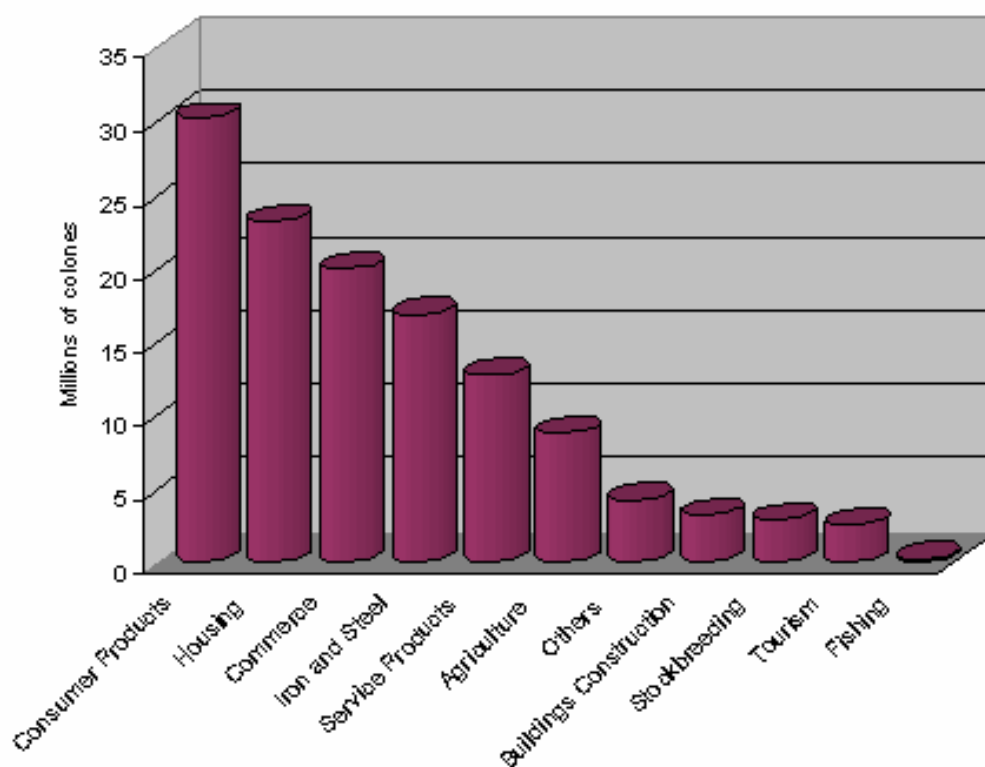
C. INSUFFICIENT INFORMATION AND RISK-TAKING

The study states that financial institutions' weaknesses in identifying the characteristics of SMEs often lead to unsatisfactory lending arrangements. They may lack in expertise to understand small and medium knowledge-based business or the flexibility in terms and conditions of financing that SMEs required may not be available. In addition, untrained banks' staff might not be sufficiently informed about lending to growing, high-risk companies. The banks often resist granting loans due to the higher overhead cost resulting from a high number of customers with smaller loan size. Due to these aspects, financial institutions must adopt the appropriate lending technologies and operation systems to enable them to lend profitably to small businesses. Of course, the role of the government is support financial institutions to achieve these objectives.

VII. ROLE OF THE GOVERNMENT AND ITS FINANCING SYSTEM TO SUPPORT SMEs.

In Costa Rica the whole banking system has been an active body in lending resources to private enterprises, including SMEs. Consumer product is the sector that has received the highest amount of credits with over 30 millions of *colones* from 1987 to 2004 (“Total”). Housing and commerce are number two and three respectively (Refer to figure C).

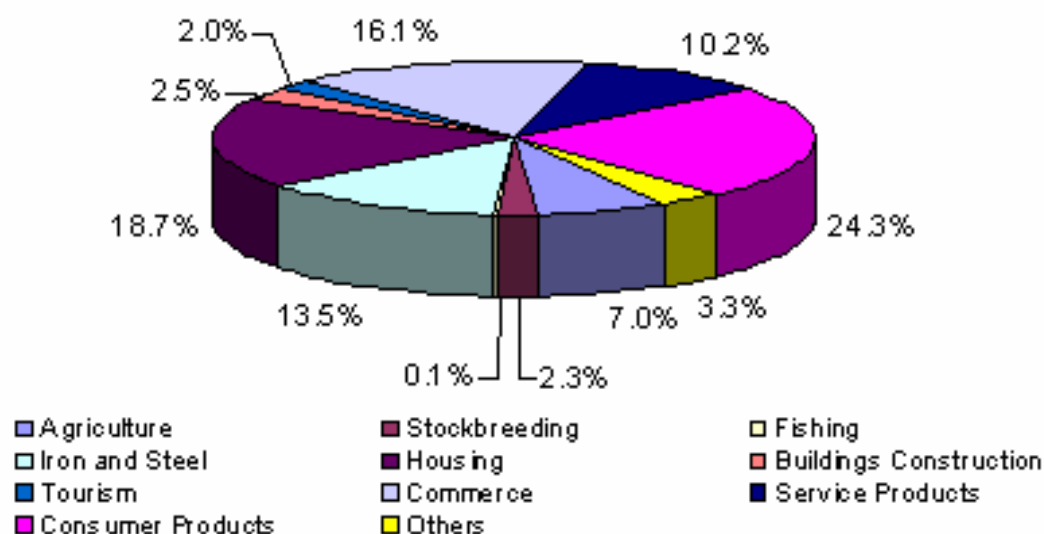
Figure D
Total bank credit to private enterprises by sector
From 1987 to 2004
(in millions of colones)



Source: Central Bank of Costa Rica. 2005

The amount received by the leading segments (e.g. Consumer product, housing, and commerce) is significant since it represents fifty-nine percent of the total banking system credits giving to the private enterprises from 1987 to 2004 (Refer to Figure D).

Figure E
Total bank credit to private enterprises by sector
From 1987 to 2004
(in percentages)



Source: Central Bank of Costa Rica. 2005

During the last year 2004, the banking system continued supporting these industries more than the rest ones. The percentage of the total funds granted to housing segment was even higher than previous years, seventy percent versus twenty-seven percent an index of 159 points. The consumer product segment obtained 107 more points in 2004, from twenty-four to twenty-six percent. However, the segments where SMEs are more concentrated, such as agriculture, stockbreeding, and fishing, do not receive important amounts of credit. During 2004 the percentage of the total funds granted to these segments was extremely lower compared to previous years with indexes of 42, 48, and 67 points respectively (Refer to Table E). These figures confirm that financial institutions lack in expertise to understand and study SMEs. Also, they validate that the banking system does not have the appropriate lending technologies and operation systems to enable them to grant credit to different types of industries.

Table E
Total bank credit to private enterprises by sector

Industry	1987-2003	2004	1987-2003 vs. 2004
Agriculture	7.9%	3.3%	(42)
Stockbreeding	2.5%	1.2%	(48)
Fishing	0.1%	0.1%	(67)
Iron and Steel	14.6%	9.0%	(61)
Housing	16.7%	26.7%	(159)
Buildings Construction	2.4%	3.0%	(128)
Tourism	2.0%	1.9%	(98)
Commerce	16.2%	15.6%	(96)
Service Products	10.4%	9.7%	(94)
Consumer Products	24.0%	25.7%	(107)
Others	3.2%	3.8%	(118)

Source: Central Bank of Costa Rica. 2005

A. EFFORTS DONE BY THE GOVERNMENT

According to the Government of Costa Rica, one of the ways to fight against poverty is creating hundreds of new SMEs. This challenge would generate prosperity and wealth for the economy. In April 14th 2004, the President of Costa Rica, Dr. Abel Pacheco De La Espriella, gave a speech to the whole nation announcing the launch of a new support network for SMEs. “This network will give a vital push to the development of the economy, and it will help in the creation and distribution of more wealth, in the generation of more jobs, and in the contribution of a more equitable country,” said Dr. Pacheco.

This governmental initiative is lead by the Ministry of Economy and sponsored by several public and private institutions, such as Costa Rica National Bank, National Learning Center Institute, and Technology Institute of Costa Rica. It provides support to SMEs by giving information, credit, assistance, and guidance in producing, commercializing, and exporting. The main objectives are to prepare SMEs to

compete, contribute to the economy of the country, and enhance the quality of products and services.

In the financing resources area, there are projects to support the SMEs. The National Bank of Costa Rica created the program named BN Development. Through this program, the National Bank has helped 24.102 SMEs from May 2002 to December 2003. Also the BN Development program provides non-financial services to SMEs, such as debit cards, leasing, and bill collection among others. The Popular and Community Development Bank has a fund of 9.000 million colones to grant loans to SMEs, while the Costa Rica Bank assigned 12.500 million of colones for the same purpose. According to Dr. Pacheco, these facts show the government support to SMEs, which will develop Costa Rican economy and help to take advantages for globalization.

In the training resources area, there are also several projects to help SMEs. The National Learning Center Institute is developing programs to train professional in different areas to help SMEs. By doing this, SMEs can count with well-prepared human resources to fulfill any business' need. The Costa Rican Chamber of Industry provides consulting services to SMEs to facilitate their participation in the international market. The National Center of Production will teach production techniques which will be an added-value for SMEs to go internationally. The Technology Institute of Costa Rica will develop programs and technical material to support design, innovation, and consulting for the SMEs. According to Dr. Pacheco, all these efforts will help Costa Rican SMEs to have access to the Europe and American networks, where more information, training, and investment can be found. Also, SMEs can take advantage of the technology and financing resources offered by the Republic of China.

These strategies and programs would aid SMEs to simplify the exporting processes, cut total costs, have more efficient services, and have better product quality. So, the government is helping out to create the right environment and internal conditions to consolidate and have more SMEs, and it is creating the right external conditions to have access to international markets.

However, all these strategies and programs are missing two important aspects: procurement and training for financial institutions, including the banking system, to study and understand SMEs. Within all programs, there is nothing about Costa Rica's Government granting SMEs with assignments and businesses to supply public and private institutions (Arevalo 21). It should plan programs that allow the government to start doing business with SMEs and not only with those corporations which offer the most economically advantageous application. Regarding the financial institutions, there are not programs to train staff to understand SMEs and change terms and conditions for these groups. Training for bank staff should teach appropriate lending technologies and operation systems to enable them to grant loan to SMEs (Perez 27).

Another challenge Dr. Pacheco is dealing with is the strategy SMEs must follow to take full advantage of the Central America Free Trade Agreement (CAFTA). Many opportunities might rise for SMEs as soon as the agreement is approved, but the government must provide the right tools to help SMEs compete within this new market. According to Dr. Pacheco, the government should organize the different SMEs industries sectors and their products, so SMEs would be more competent to commercialize in this market and prepare to minimize any difficulty and risk this agreement might bring.

VIII. HOW THE FREE TRADE AGREEMENT BETWEEN CENTRAL AMERICA AND UNITED STATES OF AMERICA (CAFTA) COULD AFFECT COSTA RICA´ SMEs

The Central America Free Trade Agreement (CAFTA) was signed by the governments of United States⁹, El Salvador, Guatemala, Honduras, Nicaragua, and Costa Rica in May 2004. Three months later Dominican Republic joined the agreement. Currently, only the Congress of Guatemala, Honduras and El Salvador have ratified CAFTA. However, hundreds of labor and trade unions, farmers, and human rights organizations considered that CAFTA will negatively affect SMEs and even increase the unemployment rate. These organizations assure that this agreement is unknown by most of the population, and it will control the Central America economy. Also, they affirm that Central America SMEs will be the most affected due to the subsidies the United State's Government grants to its SMEs. Finally, they argue that this agreement focuses its energy on merchandising and not on people (Zacarias 23).

Businessmen express that CAFTA would open new markets, but it would bring more competition to the market as well. For the manufacturers the agreement will bring new levels of production efficiency and the opening of new markets for their products. Some manufacturers even started to speed up the process of enhancing their procedures for quality control and production. According to these SMEs executives, CAFTA is the opportunity they were waiting for to boost up as professional companies. Even though this pact would bring direct competition, substitutes and complementary products, it would help to balance the market conditions for all the participants. On the other hand, several executives say that currently they are struggling with fierce competition, so they ask themselves: What is going to happen

⁹ CAFTA has yet to be presented to the U.S. Congress for approval. Trade Promotion Authority mandates that Congress cannot amend the agreement, but can only vote to approve or reject it.

when more competitors from United States enter in the market? (Mendez 4) Table F summarizes the positive and negative aspects SMEs' executives point out about CAFTA and Appendix B offers a more detailed explanation of the advantages and disadvantages of this agreement (Hernandez 11).

Table F
SWOT Analysis by SMEs' executives

Strengths	Weakness
<ul style="list-style-type: none"> ▪ Technology ▪ Qualified labor ▪ Raw materials 	<ul style="list-style-type: none"> ▪ Lack of capital ▪ SMEs ▪ Lack of protection
Opportunities	Threats
<ul style="list-style-type: none"> ▪ Market expansion ▪ Better products and services quality ▪ Increase production 	<ul style="list-style-type: none"> ▪ Bankruptcy ▪ Unemployment ▪ Disloyal competition

Source: Prensa Libre. CAFTA expectations. 2005

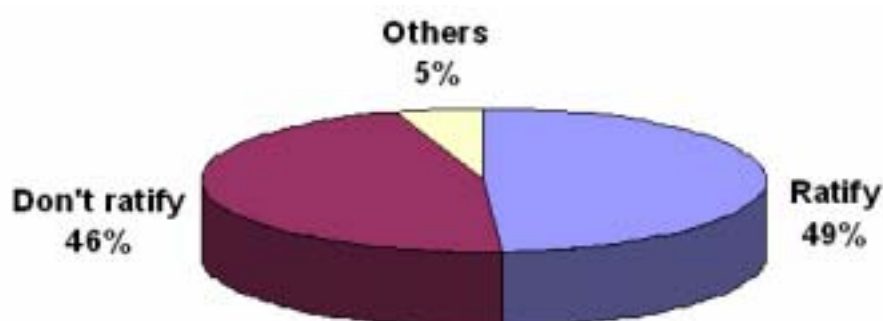
Due to the opposition by social organizations and political parties, the President of Costa Rica, Dr. Abel Pacheco, has not sent CAFTA to the Congress to be ratified. His two main reasons to delay the process are: guarantee the wellbeing of the poor class and approve the new fiscal policy plan, which has been in discussion over the last two years. In April of this year, Dr. Pacheco appointed a commission of five experts in the topic to study CAFTA in a more detailed way. These specialists would help Dr. Pacheco to decide if he sends the agreement to the Congress to be ratified or not.

According to a research done by UNIMER¹⁰ in April of this year, forty-nine percent of the interviewees would approve the ratification of CAFTA and forty-six percent

¹⁰ UNIMER (associated to Research International) is a full service research agency with the expertise and resources to undertake both qualitative and quantitative studies in the areas of marketing, media, public opinion, communication and business-to-business. It consists of an interdisciplinary team, recognized as one of the most prestigious in Central America.

would not (Refer to Appendix C). This result suggests that more information about this agreement must be released. People need more facts to fully understand CAFTA and identify all the positive and negative aspects. Based on this understanding, they can reject or not the agreement and all its consequences. In fact, the citizens with higher education, better income, and living in urban areas show a higher support level to approve the agreement.

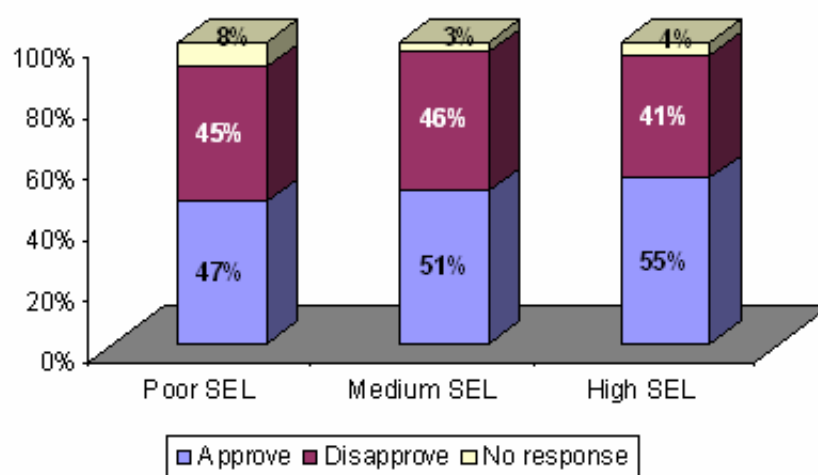
Figure F
Would you ratify CAFTA?



Source: UNIMER. Overall answer. 2005

Figure G shows that as SEL goes higher, CAFTA receives more support by the citizens. For instance, in the lowest SEL forty-seven percent of the citizens support CAFTA, but in the high SEL fifty-five percent support it.

Figure G
Would you ratify CAFTA? By SEL



Source: UNIMER. By SEL. 2005

A. AMERICANS OPPOSE CAFTA TRADE AGREEMENT

The organization Americans for Fair Trade¹¹ released the results of the survey done by the research firms of Ayres, McHenry & Associates, Inc.¹² and Ipsos-Public Affairs,¹³ which shows that fifty-one percent of North Americans oppose CAFTA. As the Costa Rican citizens, Americans are concerned with the negative impact this agreement would have on the economy and the possible increase in the unemployment rate (Refer to Appendix D).

According to Ernest Baynard, Executive Director of Americans for Fair Trade "the survey clearly shows that a strong majority of Democrats and Independents and almost half of all Republicans oppose CAFTA. These results should send a powerful message to Congress that their constituents will choose their farms and jobs over another flawed trade deal. [...] The survey also shows that Americans are all too familiar with the failed promises and negative impact of NAFTA [CAFTA's older brother] and are rightfully wary of more of the same"

The United States International Trade Commission found that the CAFTA will cause significant job losses across many sectors in the U.S. as NAFTA destroyed an estimated 880,000 jobs (Jaramillo 23), and the survey confirms this issue when fifty-two percent of the interviewees said that their primary concern was the loss of jobs. According to the Americans for Fair Trade' survey, these are some concerns U.S. citizens have about CAFTA:

11 This coalition includes producers of textiles, small and medium sized manufacturers, beef and cattle ranchers, farm organizations, organized labor, commodity groups, religious congregations, faith-based organizations and others.

12 It is a national public opinion and public affairs research firm located in Alexandria, VA that specializes in providing quality research and strategic advice to corporations, associations, and political candidates.

13 It is a non-partisan, objective, public affairs company made up of campaign and political polling veterans as well as research professionals.

- “69% of voters said that CAFTA's lack of requirements for Central American countries to protect the environment and restrict child labor makes them less likely to support the deal.”
- “56% of voters said that CAFTA's negative effect on U.S. sovereignty, by allowing foreign corporations to sue the U.S. outside of our judicial system, makes them less likely to support the deal.”
- “Immigration is also an important concern for voters. When presented with a positive argument that CAFTA will help reduce illegal immigration by providing economic opportunities in the CAFTA countries, 45% of voters said it would make them more likely to support the deal. Unfortunately, studies have shown that immigration increased substantially in the years after NAFTA was implemented and many believe CAFTA will strongly follow suit.”

B. TAKING ADVANTAGE OF CAFTA

SMEs have the capacity to be flexible in the elaboration and commercialization of products and services. These enterprises can produce small amount of products and comply special requirements by specific customers. This benefit must allow many small manufactures to become important exporters of goods with designs and especial requirements not supplied by large corporations (Arevalo 23). The reason large corporations are not interested in this type of goods is that they might be too expensive to produce in small quantities or they are simply not part of their strategic plan (Bonilla 29). In this case the government must use CAFTA benefits and grant several SMEs with prime contracts to supply these special goods instead of a large company. In order to help SMEs to be competitive in the new markets, the access to credit and technology are fundamental variables that the government must work on before ratifying CAFTA.

IX. STRATEGIC ALTERNATIVES TO ASSIST AND FINANCE SMEs

The government has run projects to aid the financing and training resources areas of the SMEs. However it could run other potential methods to assist SMEs. For each new alternative, it must consider the benefits and costs and choose the best option to provide SMEs with the right tools to have a healthy growth in the local and international markets. There are three new alternatives the government could follow: fund already existing institutions that help SMEs, promote and support clustering process, and enhance the private and public banking system.

A. ENHANCE ALREADY EXISTING INSTITUTIONS

Once simple strategy the government could follow is to support the already existing institutions which help SMEs in Costa Rica, such as SICE and FUNDES. One well-known company is the Organization for the Micro Enterprise Network -the Spanish acronym is REDCOM- which helps more than one hundred thousand persons in this country. This institution focuses its efforts on family companies that can not comply with the banking system requirements. The government can take advantage of the expertise these institutions have gained over the years and the geographic coverage they serve. REDCOM has twenty-one affiliates located across Costa Rica's territory. In the metropolitan area it has ADESTRA, ADAPTE, ADRI, ACORDE, ANDAR, CEFEMINA, CREDIMUJER, FOMIC, Women Foundation, FUNDEBASE, FUNDECO, FINCA, and APTAMAI; in the south it has APIAGOL and ADRI; in the Caribbean zone CREDIMUJER, Women Foundation, and ADRI; in the north FUNDECOCA, ASOPROSANRAMON, and ADAPTE; finally in the pacific area ODRES, FINCA, ADAPTE, and CREDIMUJER.

The impact of these twenty-one institutions is enormous. They help families that attempt to fight against poverty by developing projects in areas such as commerce,

agriculture and services. REDCOM's credit portfolio has 22.000 SMEs, from which fifty-two percent are located in rural areas and forty-seven percent are owned by women. To note, REDCOM is generating hundreds of new jobs in Costa Rica. The average credit per SMEs is US\$1500 with short terms, so people do not pay excessive interests during the lifetime of the loan. The interest rate applied is similar to the one offered by the government banking system, thus it is lower than the one offered by private institutions. REDCOM characterizes itself for having fast service, making the credit process easy and flexible, and having easy-to-comply requirements. This year 2005, REDCOM plans to allocate 11.000 more credits and with the help of the government that amount can be doubled or tripled. The network is already in place and ready to continue helping people; all the government has to do is allocate funds in this network and take advantage of REDCOM's expertise in service and coverage. The main disadvantage for the government is that it would not capture all the interest gains it would if it provides the loan using its own banking system. However, the main reason of these credits is not just revenues but the development of several new SMEs and the creation of thousands of new jobs.

B. SUPPORT AND PROMOTE CLUSTERING

Clustering is an excellent alternative for the SMEs to face CAFTA. It is extremely important for the Costa Rica's Government to create tools and design rules that facilitate the structuring of clusters. These tools and rules must help SMEs to build reliable cluster relations among them so they can attend the local and international markets. As any joint venture it is important for enterprises that work together to have a common vision of their clusters ambition, internal structure, objectives and strategies. Since CAFTA's ratification is "around the corner," this vision must be established at any moment during the clustering process and not before.

It is also important that the government helps the partnering companies to understand the international markets and provide the right tools to focus on them. This method of “international” association among SMEs can bring collective efficiencies, greater livelihood and environmental benefits for this type of companies. Clustering would help SMEs to overcome problems of technology and scale and to gain competitive advantage. In addition, this association or industrial clustering would help to lower high transaction costs which are a major impediment for SMEs. Additional advantages this strategy brings are costs reduction, time to market, knowledge transfers, better product quality, extension of business contacts, and better control on costs and selling prices.

It is known that not all SMEs will start exporting their goods after CAFTA’s ratification, but many will do so thanks to clustering. For instance, a SME which export candles buys its raw materials from other SMEs. This effect would benefit thousand of non-exporting companies to grow and generate cash thanks to CAFTA. This vital strategy would help SMEs to be able to produce large volumes of goods and have access to high technology. A benchmark institution for the Costa Rica’s Government could be AMPES (El Salvador Small and Medium Enterprises Association). This association already contacted Salvadorian businessmen who live in United States interested in selling goods produced in El Salvador to the North America market.

C. ENHANCE THE PRIVATE AND PUBLIC BANKING SYSTEM

There are three steps the government must work on in its banking system to create better solutions for SMEs, diminish the investment risk for the private banks’ shareholders, and obtain an attractive rate of return for the entire banking system. First of all, the government must promote a flexible environment for the venture

capital specific to SMEs. Among all the requirements the banking system is currently asking these enterprises high interest rate and unreachable collateral have the biggest impact in SMEs' chance to have access to credit. The government and its banking system must realize that SMEs play a vital role to the Costa Rica's economy. These enterprises deserve special treatment from the government to help them supply those markets and niches not served by large corporations, so financial aid, with lower interest rates and rational collateral, must be provided by the government and its banking system. Second, the government must tailor credit in its banking system and other similar institutions to the need of SMEs. Simultaneously the government must create tailored programs for other SMEs' needs such as technology, business development, technical assistance, training, and fiscal and labor assistance. In addition, these programs must be planned by industry, since every industry has different needs. Finally, the government must give a greater emphasis on training programs to help banks' staff and upper management understand the unique requirements of SMEs better. Trainings and courses about lending to growing, high-risk companies is a priority for the banking system. This strategy will allow banks' staff to have the appropriate tools to serve SMEs with better lending technologies and operation systems.

D. CHOOSING THE BEST STRATEGIC ALTERNATIVE

All three alternatives offer more benefits than costs for the government. Funding already existing SMEs institutions is an easy way to go. Government would save time, operating costs, and loan management. These advantages are extremely attractive. In addition, the government would take advantage of the expertise in service and coverage these institutions have in attending and supporting SMEs. The main drawback of this strategy is that the government would capture less interest

gains than using its own banking system. Regarding clustering, it is a new type of business for most of the SMEs. The main costs for the government would be the elaboration and teaching of tools and rules to develop clustering processes. These processes take time to implement, however, there is not enough time since CAFTA is about to be ratified. This situation is a negative aspect for the government and the SMEs and it would impact the costs of the clustering processes. The enormous advantage of clustering is that more SMEs will enjoy the benefits of new markets, creating thousands of new jobs and enhancing the local economy. Finally, enhancing the banking system is the most costly alternative, since the process of lowering credit standards raises the credit risks for the entire banking system. Also, by serving thousands of small credits increase the operating costs and credit risks of the banks. However, currently the amount of people not attended by the banks is vast. If the banking system serves these new segments, its profit earnings will rise above the costs originated for attending SMEs. For sure, these actions would act in the interest of private shareholders and the Costa Rica's Government.

All three alternatives are really attractive to help develop and support thousands of SMEs, so the Costa Rica's Government should execute all of them. There is not a justified reason to exclude one strategy or only to choose one. Each strategic alternative can be performed simultaneously to assure success in the campaign of enhancing the economy, taking advantage of CAFTA, and reaching and helping a higher amount of SMEs.

X. SUMMARY AND CONCLUSIONS

SMEs are a vital party in the development of the Costa Rica's economy, so the government and its financial system must support them in order to help them grow and to fully exploit their business talent and entrepreneurship spirit. However, the government is not doing a good job in this matter. Costa Rica's effort to support these companies is not having a positive impact among SMEs executives. Most of these entrepreneurs do not know about the politics and programs that the government and public institutions implement to develop, support, and promote SMEs. Those few executives who know about the government efforts state that they do not fulfill their businesses' needs at all.

SMEs stimulate the economy by creating new jobs and bringing innovation into the markets. Even though these entrepreneurs have low production capacity, they serve markets not reached by large corporations. These issues make the economy stronger and more competitive in the local and global environment. In addition, the quality of living is improved by placing more wealth into the economy.

As it can be seen, SMEs are extremely important for Costa Rica, however, they do not obtain a fairly treatment by the banking system. The accessibility to credit is complicated or hard to match. The two biggest barriers are interest rate and collateral. Both obstacles are sometimes unreachable since SMEs represent high-risk businesses for the banking system. Other important barriers are legal and bank fees, general requirements to be a creditor prospect, paperwork, and loan terms.

In Costa Rica there is not a successful financial system for SMEs, although the banking system is solid and robust. Banks are deficient in understanding the financial conditions SMEs have. Upper management does not realize that SMEs are formal economic units and they must be an integral part of the total economy and

received a special treatment over other economics units, such as large corporations. The bank' staff has not been trained about lending to growing, high-risk companies, and they do not grant loans due to the higher overhead cost resulting from a high number of customers with smaller loan size. Banks' upper management and staff demonstrate a very narrow business vision. On the other hand, other entities, such as SICE and FUNDES, see a lot of potential in SMEs and have developed new projects (e.g. MiPyme.com) to help them grow and enhance the economy.

Regarding CAFTA, this agreement brings positive and negative issues for SMEs. It would open new markets, allow new levels of production efficiency, force better procedures for quality control and production, and help to balance the market conditions for all the participants. On the other hand, it would bring fierce competition to the market and more substitutes and complementary products. Several people believe that the biggest negative impact CAFTA will bring is unemployment, since many SMEs will disappear due to the subsidies the United States' Government would grant to its SMEs. Also, people state that this agreement focuses its energy on merchandising and not on people. However, SMEs can take advantage of this agreement by serving markets which would not be part of the strategic plans of large corporations. Of course, SMEs need help from the government to achieve this by allowing SMEs to have access to credit, training, technology, quality control standards, and research. In conclusion, SMEs play a vital role in the economy of Costa Rica, and the government must fully understand their role. It must offer special treatment to SMEs by including policies that promote a positive business environment for these entrepreneurs. To be more successful, this business environment must include a better access to credit, easier lending requirements, more funding to private institutions, and newer tools (i.e. clustering).

XI. OTHER RECOMMENDATIONS

Beside the main recommendation of combining three strategies (fund already existing institutions that help SMEs, promote and support clustering process, and enhance the private and public banking system) some other recommendations are stated:

- By ensuring a competitive government contracting process, SMEs will have a favorable environment to prosper. The government must grant SMEs with direct prime contracts or subcontracts to supply public and private institutions in niches where large corporations do not provide their goods and services. The government procurement sector would offer opportunities for SMEs to enter the marketplace and grow.
- One of the main disadvantages for SMEs is R&D funding, for CAFTA requires high quality standards, environment protection, and special production labor conditions. If SMEs do not comply with these requirements, they could be tough obstacles to compete and export. A way to solve this situation is by bringing more FDI into the country. In order to achieve this, the government needs to provide more subsidies to SMEs, so the Costa Rica's market will be once again more attractive than China and India markets. SMEs could use FDI to place in programs to enhance the quality of their standards (i.e. ISO).
- Large corporations and SMEs should work together and take advantage of CAFTA. Large corporations should help local SMEs in Costa Rica upgrade their production facilities so that SMEs could meet CAFTA and large corporation's demanding quality standards. By doing this, SMEs would be able to serve large corporations as well as other global firms. This upgrading process would help SMEs to become highly competitive in new markets and be ready for any future Free Trade Agreement.

XII. APPENDICES

APPENDIX A

FUNDES of Costa Rica's research about SME's development problems

Research Technical Information
Data collection dates: From August 2000 to January 2001
Sample of companies: 553 SMEs (57.5% small companies and 42.5% medium ones) from four different sectors: agriculture (14.8%), manufacturing (17.5%), commerce (37.4%) and services (33.2%). This sample distribution represents the total SMEs population distribution.
Objective To find out the development problems SMEs are facing.
Geographical distribution of the sample 75.6% of the interviews were conducted in the Central Region of the country and 24.4% in the rest of the country. This sample distribution represents the total SMEs population distribution.
SMEs definition This study adopted the definition of the Ministry of Economy, Industry and Commerce, which includes all companies from the agriculture, manufacturing, commerce and services with a number of employees between 6 and 100 (From 6 to 30 in small companies and from 31 to 100 in medium ones).
Margin of error 5.5%

APPENDIX B

Advantages and Disadvantages of CAFTA for Central America

Advantages			
Commerce	New consumers	Economy	Protection
<ul style="list-style-type: none">• It will enhance the expansion and diversification of the commerce in all involved countries	<ul style="list-style-type: none">• As soon as the agreement is approved, 99% of the Costa Rican product could be traded in the United States market of 280 million of consumers, paying \$0 in exporting tariffs.	<ul style="list-style-type: none">• According to the Economic Commission for Latin America (CEPAL), GNP will increase by 7% in Central America	<ul style="list-style-type: none">• When the United States' exports threaten the local industry, the government can apply the defense mechanism called "safeguard"
<ul style="list-style-type: none">• It will eliminate the trade obstacles and facilitate the flow of goods and services		<ul style="list-style-type: none">• In the worst scenario the economy growth will be 2.3% in Central America.	<ul style="list-style-type: none">• "Safeguard" increases the importing tariffs during a period of four years.
<ul style="list-style-type: none">• It will promote the fair competition in the free enterprise	<ul style="list-style-type: none">• 81.9% of the United States' products could be traded in Costa Rica	<ul style="list-style-type: none">• In 2004, Costa Rica had a growth rate of 5.2%.	<ul style="list-style-type: none">• There is an especial "safeguard" mechanism, which places a period of five years in the textile industry.
<ul style="list-style-type: none">• It will increase the FDI in the Central America countries			
<ul style="list-style-type: none">• It will protect the intellectual property rights and the respect to the law.			
Disadvantages			
Labor	Medicine	SME's	Subsidies
<ul style="list-style-type: none">• United States could apply infractions of US\$15 million to those companies that do not meet the labor terms.	<ul style="list-style-type: none">• The intellectual property rights will affect generic products: this industrial protection will raise the price of medicines and will delay the scientific development of the pharmaceutical industry.	<p>The lack in measuring the differences of the economy (asymmetry) in each Central America country will bring the destruction of the SMEs and the agro industry.</p>	<ul style="list-style-type: none">• The subsidies of the United States to its agricultural producers will negatively affect the Central America's agricultures.
<ul style="list-style-type: none">• This agreement is considered an intromission of United States in the design of the Central America's labor policies.			<ul style="list-style-type: none">• Rice, corn, and beans producers will be the most affected ones when its products are compared to the United States ones.
<ul style="list-style-type: none">• It will be a labor surplus due to the unemployment increase.	<ul style="list-style-type: none">• The main rejection is to the 20-year protection in patents of agro-chemistry and medicine formulas. To note, if a new property is found in these formulas, the patent increases by 5 years.	<ul style="list-style-type: none">• This situation will generate unemployment and loss in the supply and demand capacity of the population.	<ul style="list-style-type: none">• The local market will be saturated with United States' agricultural products at very low prices.
<ul style="list-style-type: none">• Some people argue that foreign investors will take advantage of this situation to offer lower salaries and benefits compared to the current ones.		<ul style="list-style-type: none">• In the short-term poverty rate will increase sharply.	<ul style="list-style-type: none">• The FDI could decrease due to the social insecurity. This insecurity is result of the unemployment.

APPENDIX C

UNIMER of Costa Rica's research about CAFTA ratification

Research Technical Information
Data collection dates: From April 1 st to April 10 th 2005
Sample: 1,415 personal interviews. 17 years old and older.
Distribution of the sample Random selection.
Objective To find out the opinion of Costa Rica citizens about approving or disapproving CAFTA.
Margin of error +/- 2.6%

APPENDIX D

Ayres, McHenry & Associates, Inc. and Ipsos-Public Affairs' research about CAFTA ratification

Research Technical Information
Data collection dates: From February 1 st to February 6 th 2005
Sample: 800 weighted respondents, with an over-sample to yield 300 Hispanic respondents. Via phone. This poll was made available in both English and Spanish.
Distribution of the sample Random selection of registered voters.
Objective Voters were surveyed on their overall opinion of free trade, their feelings toward NAFTA, and their perception of CAFTA. Voters were questioned about their opinions on CAFTA before and after being presented with various arguments supporting or opposing the agreement.
Margin of error +/- 3.5% for the national sample and + 5.7% for the Hispanic over-sample

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